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Economic Research
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Financial Markets

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After falling sharply at first, bond prices began to firm up a little on Thursday, and the gains held up despite another bad inflation number; the September CPI was up at a 13.2% annual rate. The markets were bolstered by the closest thing to favorable news since October 6--a hint of slower money growth. But before that, bond yields had pushed to new highs in very wild trading, and the markets are still straining to cope with the uncertainties of monetary policy under the Federal Reserve's revamped procedures. In the government market, the Treasury found itself putting a 12 5/8% coupon on its latest two-year note offering, up 2 1/2 percentage points over the old record established just last month. And in the wake of recent heavy dealer losses, the very high cost of financing inventory, and substantial incentive to remain short, more records could be set next week at the Treasury's $6.75 billion quarterly financing, which will include a 3-1/2-year note, a 10-year note, and a 30-year bond.

The weekly money supply statistics showed a modest $700 million decline for M_1 and only a slight $500 million gain in M_2. Equally significant were the downward revisions in the week-earlier levels, $3 billion for M_1 and $2 billion for M_2. The money supply revisions, due to an unnamed bank's huge reporting error that went undetected by the Fed, pointed out again the hazards involved--for both the Fed and Fed watchers--in relying too heavily on weekly money supply as a guide to monetary policy. Still, while it is too soon for the Fed's October 6 policy actions to be having an impact, the revisions seemed to revive market hopes that the cumulative effect of escalating rates since the summer would begin to restrain monetary expansion.

In the money markets, Federal funds continued to trade in a wide 12%-20% range, averaging around 15%. Other short-term rates improved a bit. But the declines still left three-month CD rates near 14 1/2%, which, even without the marginal 8% reserve requirement imposed October 6, reflects a cost of funds of roughly 16%. Thus, even though the nation's major banks pushed the prime rate to 15%, it does appear that the industry is trying to cooperate with Fed Chairman Volcker, who is encouraging moderation in adjusting the prime to the volatile conditions in the short-term markets.

Curiously, one rate that hasn't been moving up is the discount rate, now at 12%. The gap between the Fed funds rate and the discount rate exceeds by a wide margin the 50-75 basis point spread that tends to encourage bank borrowing at the discount window; and this week's borrowings of $3.0 billion were the largest this year. While the Fed can clearly exercise nonprice control over member bank borrowings, the authorities' obvious reluctance to push the discount rate into line with other rates remains somewhat of a puzzle, particularly if borrowings are to play a pivotal role in the Fed's efforts to control reserves directly.

Glenn C. Picou

Money Market Rates

Irving Trust Company A Charter New York Bank

	10/26/79 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	15.00%	14.50%	10.25%
Effective since	10/23/79		
Discount Rate at Federal Reserve Bank	12.00	12.00	8.50
Federal Funds	15.14	13.75	9.12
Repurchase Agreements	12.75	12.25	8.50
U.S. Treasury Issues - Yields			
Bills			
3 months	12.30	12.75	7.97
6 months	12.95	13.25	9.15
1 year	12.50	12.60	9.34
Coupons			
2 years	12.11	12.10	9.10
4 years	11.29	11.15	8.81
7 years	11.03	10.70	8.79
10 years	10.85	10.60	8.79
Long Bond	10.30	10.00	8.76
Negotiable Certificates of Deposit-Secondary Market			
1 month	14.25	13.75	9.15
3 months	14.50	14.15	9.90
6 months	14.50	14.50	10.37
1 year	14.25	13.75	10.20
Bankers' Acceptances			
1 month	14.05	13.75	9.20
3 months	14.40	14.50	9.65
6 months	14.70	14.80	9.90
Eurodollar Deposits			
1 month	15.31	14.00	9.63
2 months	15.50	14.63	10.06
3 months	15.75	14.88	10.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	12.00	12.00	8.00
1 month	13.90	13.25	8.95
3 months	12.88	12.75	9.00
Bank Holding Companies			
1 month	14.00	13.13	8.95
Dealer Placed:			
3 months	14.25	13.38	8.97
New Aa Corporate Utility Bond	11.75	11.25	9.35
Tax Exempt			
6 month Project Notes	6.30	5.90	4.80
12 month Project Notes	6.00	5.75	4.95
20 year AAA Bond	6.85	6.95	5.85

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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